Does the right hand know what the risk hand's doing? by Ian Hendra

Last time I wrote about the importance of the old QA mantra 'get it right first time, every time'. As I rev up to deliver NZOQ's first course on Risk Management I've been pondering on it at some length. As the world reels from the inevitable consequences of the behaviour of US mortgage lenders, I wonder why those at the sharp end actually did it.

Clearly it never occurred to anyone in the mortgage supply chain that lending more money than an asset was worth was doomed to fail. Yet I'll wager there was compliance to the hilt with banking procedures at every stage in the process; after all if there wasn't, the courts would be full of fraudsters. And whilst the media reports stories of bonuses being pulled, the fact is that those same bonuses came from compliance with a contract of one kind or another.

It seems we're happy to shrug and say the system fell over, but the QA guy in me suggests there was no system at all, or if there was it was based more on making sales than protecting the integrity of assets. I've said this before, too: in his autobiography, Dr Jack Welch, Chair & CEO of GE remarked that "what you measure is what you get" - WYMIWYG, I call it. He gave an example of prices being slashed to below cost to meet bonus targets for sales. I guess in the simplest terms something similar has happened in the US; mortgage sellers being measured on the volume of mortgages let, not the risk being exposed.

Obviously, a risk management system failed, if there was one, which is interesting because most of the current corporate wisdom on risk management has come from the financial sectors. I've always been sceptical about the bona fide of this, quite frankly, because risk management related to hazard identification has been around elsewhere, very successfully and more visibly, for much longer. And that's the point of difference with the NZOQ Risk Management course: it's not a narrow isolated view, it's an integrated approach that takes on board the whole nine yards.

Hierarchy is the key

It's the order of the hierarchy that matters, really; top down is the only way to make it work in other words, and that's a QA mantra too, of course. In reality, risk management is much more a governance imperative than a job description for a staff member; it's the domain of business owners and directors whose absolute responsibility it is to work in the interests of the organisation and its stakeholders.

It's a reasonable expectation, therefore, that at the strategic level, 'governors' will determine what level of risk they will tolerate; after all, usually it's their money on the line. It is management's role to monitor the organisation's performance against these risks by identifying and dealing with the hazards that expose them. In cases where processes and procedures are designed to manage the hazards that expose these 'enterprise' risks, then ensuring compliance is the only way to provide assurance that such risks are under control. That's where the people at the pointy end come in. Without pouring cold water on the survival need for continual improvement at all levels, it's their job to comply with policy and standards in the first instance.

A vineyard story

Here's a story that also helps with the discrimination between risk and hazard. Over the years, the owners of a vineyard have put up with significant losses of product in storage and transit. Consignments have fallen off the backs of trucks, containers have fallen into the sea, there has been pilfering, and temperature-controlled environments have failed. Customers have complained about non-delivery and there have been returns. The insurer has raised premiums significantly.

At business planning time, the Board reviews its risk register and decides that the time has come to deal with transportation risk. They define a risk of the loss of 2 consignments of 100 boxes a year as acceptable due to storage and transportation problems. Management uses good old common sense process mapping to identify the hazards in the delivery phase to include storage on site, end to end security, loading procedures, road freighting specifications, shipping standards, and off-shore delivery requirements. Compliance monitoring and performance reporting procedures are included in the process mapping.

Management information is thereby reported in decreasing levels of detail back to the monthly summary management reports received by the Board and their senior managers. Insurance is bought against this level of risk, but management includes the process documentation in its submission to insurers. ISO 9001 certification is procured to validate the claim that the delivery processes are in place. The Board calls for and budgets accordingly for internal auditing to check not only the integrity and effectiveness of the transportation and storage processes themselves but also that management's compliance monitoring is in place and working. Internal auditing also checks that problems arising are dealt with in accordance with the original risk as defined by the owner (2x100 boxes a year). Hence, a governance driven, management implemented risk management system is in place, based on Dr Deming's Plan-Do-Check-Act cycle.

Telling right from risk

It seems to me that this was not happening systemically in the US mortgage business….but as I said, there will have been compliance monitoring 'for Africa' at the delivery end, but what for? Just goes to show what happens when the 'right' hand doesn't know what the 'risk' hand is doing. You might like to ponder on where your organisation fits on a scale from Common Sense to American Mortgage Lender....Slainte!